Not Playing Well with Others

The Dangers of Being Deemed a "Recalcitrant Insurer"

By Robert L. Sallander, Jr.

A number of protections are sacrificed by a recalcitrant insurer; it is dangerous to become one.

We have all been there: A company is sued for a loss that occurred over a number of years during which the company was covered by multiple insurers. The majority of the insurers dutifully agree to share the defense, but inevitably, one refuses. No amount of factual evidence, legal authority, or cajoling persuades it to pay its fair share. That insurer runs the risk of being labeled a "recalcitrant insurer." *Liberty Mut. Ins. Co. v. Mid-Continent Ins. Co.*, 405 F.3d 296, 304 (5th Cir. 2005).

Because the other insurers have supplied the policyholder with a defense and the policyholder likely will not have an interest in pursuing the recalcitrant insurer, one of the defending carriers will have to do so, usually by asserting a claim for equitable contribution. The consequences of breaching the duty to defend when a policyholder sues an insurer for breach of contract are well known. But what are the consequences when a policyholder receives a defense from some insurance carriers but one insurer sues another seeking equitable contribution rather than breach of contract damages? Although someone might think that an "insurer v. insurer" dispute would result in a more level playing field, such an assumption would be incorrect. In such actions, the normal burdens of proof shift to work heavily against a recalcitrant insurer, almost guaranteeing that it will pay a larger share of the defense costs than if it had participated willingly by paying a share.

This article will review a number of protections sacrificed by a recalcitrant insurer and demonstrate the dangers of becoming one.

A Court Will Not Accept an "Insufficient Information" Defense

A court will not permit a recalcitrant insurer to stick its head in the sand. If the facts establishing the duty to defend were known to other insurers, a court likely will hold that a recalcitrant insurer had such knowledge. As one court has written, "Contribution rights of coinsurers who insure the same risk are based on the equitable principle that the burden of… defending the insured… should be borne by all

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the insurance carriers together, with the loss equitably distributed among those who share liability for it…." *Fireman's Fund Ins. Co. v. Maryland Cas. Co.*, 65 Cal. App. 4th 1279, 1294 (Cal. Ct. App.1998). Because a claim for equitable contribution in the first instance depends on proof that another party is liable for the same debt, an aggrieved insurer must first establish that the defendant had a duty to defend but failed to honor it.

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An insurer prosecuting an equitable contribution action has the same burden as a policyholder in establishing the duty to defend. An insurer's duty to defend is determined by comparing the allegations in the complaint with the terms of the policy. *Fieldston Prop. Owners Assn., Inc. v. Hermitage Ins. Co., Inc.*, 16 N.Y.3d 257, 264 (N.Y. 2010). The insurer has a duty to defend if the plaintiff in the underlying lawsuit alleged facts that would establish the insured's liability for a claim covered under the insurer's policy if the plaintiff proved them. *Scottsdale Ins. Co. v. MV Transportation*, 115 P.3d 460, 466 (Cal. 2005).

Frequently an insurer defending against a contribution action will assert that it did not receive sufficient information to trigger its duty to defend. *See*, *e.g.*, *Monticello Ins. Co. v. Essex Ins. Co.*, 162 Cal. App. 4th 1376 (Cal. Ct. App. 2008) (arguing successfully that the insurer facing a contribution action did not receive sufficient information to trigger its duty to defend.) To combat the "insufficient information" defense, a prosecuting insurer need prove only that the defense-triggering information was known or, upon reasonable inquiry, knowable to the recalcitrant insurer. *See*, *e.g.*, *State Farm Fire & Cas. Co. v. First Nat'l Bank & Trust Co.*, 277 N.E.2d 536 (Ill. Ct. App. 1972) (affirming that insurer's failure to investigate the insured's material misstatements waived a defense). A recalcitrant insurer's refusal to investigate does not excuse it from its liability for its equitable share of the incurred defense costs. *Am. Int'l Bank v. Fid. & Deposit Co.*, 49 Cal. App. 4th 1558, 1571 (Cal. Ct. App. 1996). When one or more other insurers had the information, it will be difficult for a recalcitrant insurer to persuade a court that the information was not knowable.

In *St. Paul Mercury Insurance Co. v. Mountain West Farm Bureau Mutual Insurance Co.*, 210 Cal. App. 4th 645 (Cal. Ct. App. 2012), the recalcitrant insurer, Mountain West, claimed that it lacked information to show that the general contractor's alleged liability arose from the work of the framer, Mountain West's named insured. Mountain West argued that the framer was not a party to the action and that Mountain West had not received copies of expert reports linking the alleged property damage to defects in the framing. The court rejected these arguments because Mountain West "rejected numerous attempts by St. Paul Mercury's attorneys to share evidence showing the damage alleged by [the general contractor] that arose out of [the] framing work." *Id.* at 651.

A Recalcitrant Insurer May Lose Important Rights

In addition to imputing knowledge to a recalcitrant insurer when determining the duty to defend, if a court that finds that a recalcitrant insurer breached its duty to defend, the jurisdictional law may deprive the insurer of important defense cost-related protections. A recalcitrant insurer may lose certain rights associated with the duty to defend such as the right to recoupment and the right to challenge reasonableness. A court also may impose pre-tender defense costs on a recalcitrant insurer. The extent of an insurer's defense obligation has been the subject of considerable litigation, particularly in so-called "mixed actions" in which a plaintiff alleges potentially covered claims against a policyholder along with claims for which the policyholder would not have coverage. Most courts conclude that the duty to defend one claim means that the defending insurer has a duty to defend all the claims in a complaint regardless of whether the policy's terms covers all the claims. *Presley Homes, Inc. v. Am. States Ins. Co.*, 90 Cal. App. 4th 571 (Cal. Ct. App. 2001); *Buss v. Superior Court*, 939 P.2d 766 (Cal. 1997); *Colony Ins. Co. v. G & E Tires & Serv., Inc.*, 777 So. 2d 1034, 1039 (Fla. App. 2000).

An insurer's obligation to defend non-covered portions of a lawsuit when a policy that it issued potentially covers other portions is a creature of the courts, not contracts. In fashioning the obligation, some courts have developed a quid pro quo that allows a defending insurer to later seek recoupment of those defense costs. For example, under the *Buss* case in California, while an insurer must defend the entire action, it may reserve the right to recoup defense fees from the insured upon showing that the insurer incurred those fees solely in the defense of claims that the policy did not potentially cover. *Buss*, 16 Cal. App. 4th at 61 n.27. *But see Am. & Foreign Ins. Co. v. Jerry's Sport Ctr., Inc.*, 2 A.3d 526 (Pa. 2010) (requiring explicit provision in policy for reimbursement). *See also General Agents Ins. Co. of Am., Inc. v. Midwest Sporting Goods Co.*, 215 Ill. 2d 146 (Ill. 2005) (declining to adopt *Buss* and requiring a policy to contain a reimbursement provision); *Tex. Ass'n Gov't Risk Mgmt. Pool v. Matagorda County*, 52 S.W.3d 128, 134 (2000) (requiring an explicit provision for reimbursement in a policy).

Recalcitrant insurers in equitable contribution actions frequently attempt to employ the right to recoupment to limit the total amount of defense costs subject to equitable contribution, often referred to as the "common fund" of defense fees. These recalcitrant insurers argue that only those fees incurred by the aggrieved insurer to defend *covered* claims, not the total amount of defense costs incurred to defend both the covered and non-covered claims, should be subject to contribution. The courts in *Presley Homes* and *Mountain West* rejected this argument.

These courts reasoned that the quid pro quo for the *Buss* right to recoupment—funding a full defense in a mixed action—is missing in the case of a recalcitrant insurer. A recalcitrant insurer has not funded a defense. Accordingly, the *Buss* recoupment right provides no basis for a

recalcitrant insurer to limit a claim for contribution to those defense costs incurred to defend against covered claims. In some jurisdictions a recalcitrant insurer that breached its duty to defend may not be entitled to seek equitable contribution at all. *See*, *e.g.*, *Cargill, Inc. v. Ace Am. Ins. Co.*, 784 N.W.2d 341, 354 (Minn. 2010). So it follows that the recalcitrant insurer should not be permitted to limit the amount of fees to be distributed equitably in the contribution action under a *Buss*-like argument. Thus, a recalcitrant insurer effectively loses the opportunity that it otherwise may have under cases such as *Buss* to limit its defense expenditures to defense costs attributable to the covered claims against its insured.

Not only is a recalcitrant insurer exposed to the full amount of defense costs incurred on behalf of the common insured in the underlying action, but it also may not challenge the reasonableness of those fees. In a contribution action against a nonparticipating insurer, the defense costs are presumed reasonable and necessary. *Aerojet-General Corp. v. Transport Indem. Corp.*, 17 Cal. 4th 38, 65 (Cal. 1997). A recalcitrant insurer waives the right to challenge the reasonableness of defense costs. *Safeco Ins. Co. v. Superior Court*, 140 Cal. App. 4th 874, 880 (Cal. Ct. App. 2006). *See also Hebela v. Healthcare Ins. Co.*, 851 A.2d 75, 87 (N.J. Super. 2004) ("Placing the burden of persuasion on the insurer is a fair and just response to its wrongful failure to defend.").

Moreover, a recalcitrant insurer may lose other common defenses designed to limit defense fees. For example, insurers frequently refuse to pay for pretender defense fees. When an insurer has not participated in defending its insured, however, it may not be able to limit the "common fund" to only post-tender defense expenses.

In *Mountain West*, the recalcitrant insurer did not raise the pretender fees issue directly, but made a similar argument, asserting that its duty to defend was not triggered until the framing deficiencies were alleged in the underlying plaintiff's first amended cross-complaint, and it was only obligated to pay those defense costs incurred after the plaintiff filed the first amended cross-complaint. *Mountain West*, 210 Cal. App. 4th at 663. The court rejected that argument, ruling that Mountain West's duty to defend "arose upon tender," which was before the date upon which the plaintiff filed the first amended cross-complaint. *Id.* Moreover, in describing the defense fees that a participating insurer could seek from the recalcitrant insurer, the *Mountain West* court made no provision for the exclusion of pretender fees: "Equitable contribution is usually allowed for… defense costs *incurred by the insurer who defended the action*." *Id.* at 661 (emphasis added).

The California Supreme Court decision in *Crawford v. Weathershield*, 187 P.3d 424 (Cal. 2008), held that an insurer that breached its contractual duty to defend was obligated to pay for all defense costs of the contractual indemnitee, even the costs incurred before the tender. While *Crawford* involved a construction indemnity agreement, not an insurance contribution action, there is no apparent reason why this more onerous rule would not also apply to recalcitrant insurers.

In *Crawford* the court noted the distinction between the duty to defend imposed by the contract and the duty to reimburse for the costs of defense imposed by California Civil Code §2778, which states, "[a]n indemnity against claims, or demands, or liability, expressly, or in other equivalent terms, embraces the costs of defense against such claims, demands, or liability incurred in good faith, and in the exercise of a reasonable discretion." According to the court, the contractual duty to provide a service is distinct from the statutory duty to pay for the cost of defending potentially covered claims, so it would seem to follow that the duty to defend is distinct from the duty to reimburse.

Extending *Crawford* to insurance contribution, the mere fact that a recalcitrant insurer's contractual duty to provide a defense, as opposed simply to pay for it, did not arise until a particular time does not mean that it is not obligated to reimburse others for previously incurred defense costs as required by statute. *See Crawford*, 187 P.3d at 434, 435. Courts in several jurisdictions have held that an insurer that breached its duty to defend, meaning a recalcitrant insurer, is liable for pretender defense expenses. *See*, *e.g.*, *Domtar, Inc. v. Niagra Fire Ins. Co.*, 552 N.W.2d 738, 752 (Minn. Ct. App. 1992), *aff'd in part, rev'd in part*, 563 N.W.2d 724 (1997).

A Recalcitrant Insurer May Also Lose Important Protections

Unlike the duty to defend, which allegations of potentially covered damages will trigger, to trigger an insurer's duty to indemnify usually requires proof of actual coverage. A recalcitrant insurer may try to leverage this burden of proof by insisting that the prosecuting insurer establish which portion of a settlement the recalcitrant insurer's policy actually covered. If the law allocated the burden of proof this way in an equitable contribution case, an aggrieved insurer would face a major obstacle to recovery because in most contribution cases the parties in the underlying case settle the case without trying it. Consequently, the parties have not established the policyholder's liability. Additionally, a settlement usually is for a lump sum and is not divided between covered and uncovered damages. Therefore, proving which portion of a settlement a nonparticipating insurer's policy actually covered would be difficult. An aggrieved insurer would face the daunting prospect of making the underlying plaintiff's case against the insured—the so-called "trial within a trial"—and having the defenses it that previously asserted on behalf of the common insured imposed against it by the recalcitrant insurer.

A recalcitrant insurer's refusal to investigate does not excuse it from its liability for its equitable share of the incurred defense costs.

If a recalcitrant insurer could insist that the prosecuting insurer sustain the burden of proving actual coverage and could use the very defenses that the aggrieved insurer had paid to develop against the developer, the aggrieved insurer, it would give a distinct advantage to the recalcitrant insurer. It dishonors the notion expressed by the *Fireman's Fund* and other courts that an insurer should not have any incentive to avoid its defense obliga-

tion because another insurer did it. *See Fireman's Fund*, 65 Cal. App. 4th at 1294. Accordingly, courts have refused to impose such a burden on an aggrieved insurer and have determined that proof of the duty to defend is also proof of the duty to contribute to a settlement. The burden then shifts to the recalcitrant insurer to prove which portion of the settlement it does *not* cover.

A recalcitrant insurer may lose certain rights associated with the duty to defend such as the right to recoupment and the right to challenge reasonableness.

See, *e.g.*, *Safeco Ins. Co.*, 140 Cal. App. 4th at 880 ("When a duty to defend is shown, nonparticipating coinsurers are presumptively liable for both the costs of defense and settlement."); *Am. Star Ins. Co. v. Ins. Co. of the W.*, 232 Cal. App. 3d 1320, 1332–33 (Cal. Ct. App. 1991).

This rule is easy to apply when a recalcitrant insurer's potential coverage includes all of the claims in the underlying action. It is more difficult in mixed actions, especially when the recalcitrant insurer's coverage represents a mere subset of the aggrieved insurer's coverage.

To illustrate, in *Mountain West*, St. Paul insured the general contractor that was allegedly liable for construction defects caused by many trades. Mountain West insured the general contractor as an additional insured only for liability arising out of the work of one trade. When St. Paul sued Mountain West for equitable contribution, Mountain West asserted that St. Paul had the burden of proving which portion of the settlement arose out of the work of Mountain West's named insured. Thus, the issue was whether the recalcitrant insurer in a mixed action is exposed to the entire settlement of the common insured or only that portion arising out of its named insured's work.

St. Paul argued that the recalcitrant insurer was liable for a portion of the entire settlement because the "arising out of" issue was a coverage defense that Mountain West was obligated to prove. St. Paul nevertheless proffered evidence showing that the majority of damages claimed in the case were attributable to Mountain West's named insured. The court adopted St. Paul's argument.

Notably a recalcitrant insurer does retain some basic protections. Even though law presumes that a settlement is evidence of the amount of the common insured's liability to which a recalcitrant insurer must contribute, the presumption is rebuttable, which allows the recalcitrant insurer to assert coverage defenses. As to those defenses, a recalcitrant insurer bears the burden of proof. *Safeco*, 140 Cal. App. 4th at 881 ("Although a nonparticipating coinsurer waives its right to challenge the reasonableness of the amount of a settlement, it retains its right to raise other coverage defenses as affirmative defenses in a contribution action—which means, of course, that the recalcitrant coinsurer has the burden of proof on those issues.").

The *Safeco* court applied this rule to require the recalcitrant insurer, with an established duty to defend, to establish the lack of coverage for any portion of the settlement payments. *Safeco*, 140 Cal. App. 4th at 881. Additionally, in *Mountain West*, by establishing Mountain West's duty to defend, St. Paul had also established Mountain West's duty to contribute to the settlement, and the burden shifted to Mountain West to meet the heavy burden of proving the absence of coverage. *Safeco Ins. Co.*, 140 Cal. App. 4th at 880 (citing *United Servs. Auto. Ass'n v. Alaska Ins. Co.*, 94 Cal. App. 4th 638, 644 (Cal. Ct. App. (2001)); *Am. Star Ins. Co.*, 232 Cal. App. 3d at 1332–33.

Thus, once a nonparticipating insurer is deemed recalcitrant because its breach of the duty to defend has been established, key defenses once available to it become heavy burdens. The recalcitrant insurer cannot require the aggrieved insurer to prove actual coverage, but instead must itself disprove coverage when the court has already found a potential for coverage and when evidence to meet its burden is not easily available because it did not previously participate in the defense.

Courts Require a Recalcitrant Insurer to Pay Only Its Fair Share

Once an aggrieved insurer has established a recalcitrant insurer's liability for contribution by proving that the recalcitrant insurer had a duty to defend and has proved the damages by showing the full cost of the defense and the settlement, the analysis turns to apportioning the costs of the defense and the settlement among the rightful insurers. First this analysis determines how many insurers shared a duty to defend, next it determines how to apportion the common settlement fund among the responsible insurers, and then it compares the contribution of the prosecuting insurer to the share the recalcitrant insurer should have paid.

Thankfully for recalcitrant insurers, courts have not ignored that the claim is one for *equitable* contribution and have held that an aggrieved insurer is not entitled to recover an amount that would reduce its outlay to less than its fair share, and a recalcitrant insurer is not obligated to pay more than its fair share even if it did not make the aggrieved insurer whole. *Scottsdale Ins. Co. v. Century Surety Co.*, 182 Cal. App. 4th 1023, 1037 (Cal. Ct. App. 2010).

Fairness, like beauty, is in the eye of the beholder. Depending on the particular facts of a case, how a court decides to allocate defense expenses may seem fair to one insurer while outrageously unjust to another. For example, in *USF Insurance Co. v. Clarendon America Insurance Co.*, 452 F. Supp. 2d 972 (C.D. Cal. 2006), the U.S. District Court for the Central District of California rejected an equal shares allocation of defense costs in favor of time on the risk, reasoning that

> it would be inequitable to apportion defense costs in equal shares because Clarendon National insured Hondo for only three months, while USF and Clarendon America each provided coverage for twelve months. Given the particular circumstances of this case, the court finds that allocation according to "time on the risk'" would be more equitable and "accomplish substantial justice" among the parties.

Id. at 1004 (footnotes omitted).

Other courts, however, allocate defense costs equally among the insurers that

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have a duty to defend. *See, e.g., Wooddale Builders, Inc. v. Maryland Cas. Co.*, 722 N.W.2d 283 (Minn. 2006). Thus, a court may require a recalcitrant insurer that only covered, for example, 10 percent of the triggered period to split the defense costs equally with another insurer that provided coverage for the remaining 90 percent of the triggered period.

Be Careful: The Deck Is Stacked Against a Recalcitrant Insurer

An example of the onerous effects of being deemed a "recalcitrant insurer" is seen in *St. Paul Mercury Insurance Co. v. Mountain West Farm Bureau Mutual Insurance Co.*, 210 Cal. App. 4th 645 (Cal. Ct. App. 2012). In that case, the framer's insurer acknowledged a duty to defend the general contractor as an additional insured but failed actually to participate. Instead, the framer's insurer argued that by asserting defenses to the construction defects on behalf of the framer, it benefitted the general contractor's defense and thus fulfilled its additional insured obligations.

The framer's insurer did not directly participate in the general contractor's defense, leaving the general contractor's direct insurer to bear the full burden of defending and settling the case for the general contractor. The general contractor's direct insurer felt aggrieved and filed a claim for equitable contribution in which the framer's insurer was treated as a recalcitrant insurer insofar as the protection of the general contractor was concerned. Bearing that moniker, the framer's insurer faced a stacked deck in the contribution action:

- The aggrieved insurer needed to prove only that the recalcitrant insurer had a duty to defend, a relatively light burden;
- Once the duty to defend was established, the law presumed that the recalcitrant insurer owed the full costs of the defense and the settlement;
- The recalcitrant insurer could not challenge the reasonableness of the defense fees or the settlement amount; and
- The recalcitrant insurer's only defense was to prove that the policy that it issued did not cover the claim, a difficult burden to bear.

Though the general contractor faced liability arising out of the work of 18 subcontractors, the framer's insurer as the recalcitrant insurer was ordered to pay 43 percent of the cost of defending and settling the case on behalf of the general contractor, ostensibly a much larger percentage than it would have paid if it had willingly participated.

It is not good to be a recalcitrant insurer. FD